

Behavior Gap

INVESTING
LIKE
AN ADULT

Sometimes it is easier to complain
about the market than to take the time
to understand it, because it allows us

to place blame on something or someone else. I recently had a client tell me that he has colleagues (highly educated colleagues) that complain that they have to keep working because of “what the stock market did to them in 2000-2002.”

This reminds me of the time when I was just old enough to start using the power lawn mower by myself. I often hit (and destroyed) sprinkler heads while mowing, and I remember running inside and telling my mom that “the lawn mower had just hit a sprinkler head.”

Lawn mowers don't hit sprinkler heads, and investments don't make mistakes. Sure it

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by people,
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was easy to get caught up in all the hype surrounding this "new economy", but it is very important to understand that the mistakes were made by people and not by markets.

If you understood (or had a trusted family advisor who understood) the basics of diversification and the importance of patience and discipline in other words: if you invested like an adult, you have done fine.

Let's say that in January of 2000 your rich uncle passed away and left you \$1,000,000. You invest it January 2000, within 90 days of what turns out to be the top of one of the great speculative bubbles. Your timing

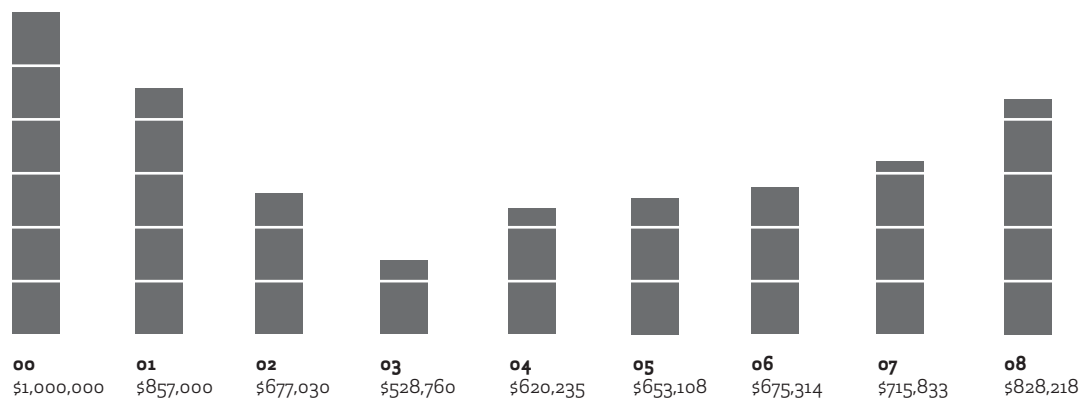
could not have been worse. Let's run through a few possible outcomes:

FOLLOW THE CROWD

Go back to January 2000. It was a heady time. Everywhere you looked people were getting rich in the "new economy". E-Trade was telling you that tow-truck drivers were buying their own island based on their day-trading profits. If you were not getting involved you were going to be left behind. It all seemed so easy: buy a few large cap growth or technology funds and retire. Now, it is important to remember that as silly as it sounds in hindsight, it was really hard to avoid getting caught up in the hype. So if you took the \$1,000,000 and invested it in large cap growth here is what your account value would have been each January:



Account Value



it's a
behavior
problem, not
an investment
problem

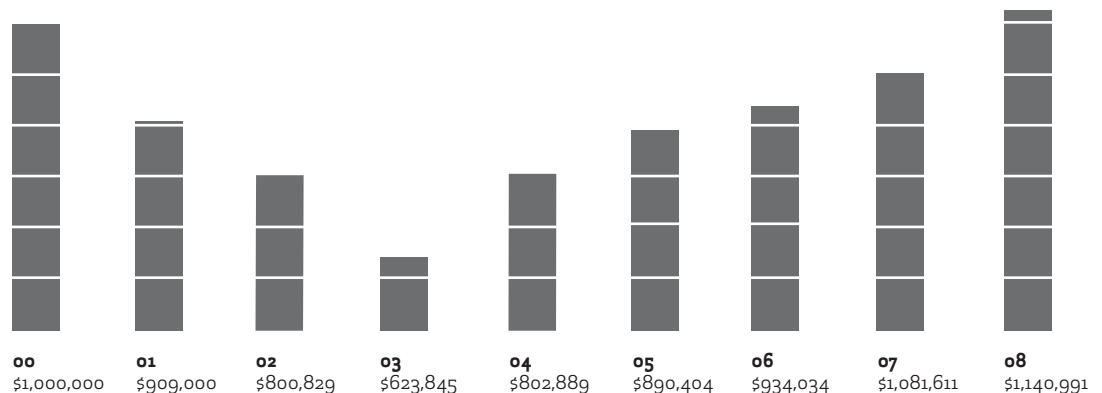
A few things to note. If this is real money, this is real scary! In 3 years you have lost over \$450,000! At this point most people in these types of investments SOLD and turned a temporary decline into a permanent loss. We know because we have the data. We can see that more money left Large Growth Funds in the last half of 2002 than at any point in history. In fact October of 2002 was the first time ever that we had 5 months in a row where people were taking more money out of stock mutual funds than they were putting in. So think about the behavior here. At the prices we had in 2000 we could not buy enough, and then the same asset is 50% cheaper in 2002 and we can't sell fast enough. The point is, that if you got caught up in the hype and invested all your money in the promise of a "new economy" and stayed

put by the end of 2007 you had made it back up to \$828,000. But most people never had the chance to get back up, because the same behavior that led them to buy in the first place led them to sell and look for the new hot investment (just in time for that to go down, but that is another story told in detail in the snapshot). So if you invested this way, and stayed put you are almost back to even. But remember the fact that you are still down is not an investment problem, it is a behavior problem.

INVEST IN THE MARKET

OK, let's say you managed to fight off the critics and stay a little more diversified. You turned off you TV, went on a media fast, and bought a S&P 500 fund. This is still just the United States and still the largest stocks but at least it is somewhat diversified. Here are your results:

Account Value



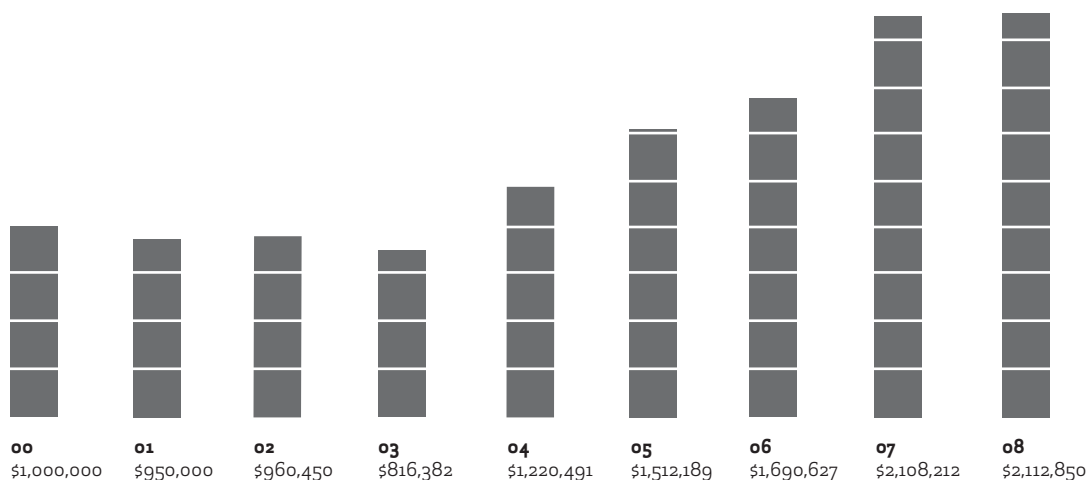
The results are a little better *if* you managed to stay the course. By January 2008 you are UP \$140,00. Again the evidence indicated that most people would not have made it through 2002-2003 to get the benefit, but if you did you are actually UP. So the lesson once again is that most performance problems are problems with the investOR not the investMENT.

**INVEST LIKE AN ADULT
(A Globally Diversified
Passive Portfolio)**

The following globally diversified passive portfolio is made up of 60% US stocks, 20% International, 10% Emerging Markets, 10% Real Estate stocks):



Diversified Passive Investment



I do not want to understate the difficulties of this period of time. Watching \$1,000,000 go down to \$816,000 is scary.

Staying disciplines at scary times is why most people need help. Unless you look in the mirror and see Warren Buffet you need help to avoid making the BIG mistake. Someone that you trust to “walk you in off the ledge”

and remind you that the downs are temporary and the ups are permanent. Someone to encourage you to go on a media fast, turn off the TV, ride your bike, go skiing, garden, *whatever*, just don't worry about your long term investment over short periods of time.

So if you invested like an adult, and had someone to help you with the natural



tendency to make the BIG mistake on January 2008 you opened your statement and it said you had over \$2,100,000. Based on all the complaining that you are hearing in the press and around the water cooler you double check, and it still says \$2,100,000. This is not some sort of fancy complex investment scheme, this is just following the time tested, boring old principles of investing like an adult.

ABOUT THE BEHAVIOR GAP

For years, a guy named Carl noticed something interesting: The real-life return of the AVERAGE INVESTOR was dramatically lower than the return of the AVERAGE MUTUAL FUND. In theory, this gap shouldn't exist, but investors were leaving money on the table and didn't seem to understand how it happened.

Carl named this phenomenon the Behavior Gap™. For over 15 years, Carl's relentless curiosity has driven him to explore why the Behavior Gap exists and to share what he knows about it. Carl's main purpose for creating the Behavior Gap is to help people close the gap by learning and practicing the best investor behavior. Carl shares his findings via behaviorgap.com and at public speaking engagements.

ABOUT CARL RICHARDS

So who is Carl? After more than ten years working in the brokerage industry, Carl went out on his own to serve as the Family Chief Financial Officer (CFO) for a select group of families. In addition to his role as Family CFO, Carl also serves in a research capacity for multiple financial firms with offices in Arizona, Nevada, North Carolina, Georgia, and Utah.

Carl received a Bachelor of Science degree in Finance from the University of Utah, and he's credentialed as a Certified Financial Planner™. Married with four children, Carl enjoys spending time outside with his family. If you want to learn more about the Behavior Gap™, feel free to email him at carl@behaviorgap.com.

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